The Carbon Tax Miracle Cure, by Alan S. Blinder, January 31, 2011

In his State of the Union address last week, President Obama called for a major technological push for cleaner energy: "the Apollo projects of our time." But when the details emerge, it is predictable that his political foes will object to the new government spending and decry the "heavy hand" of government in telling business what to do. Fortunately, there is a marvelous way to square the circle.

Under this policy approach, decision-making is left in private hands and the jobs created will be in the private sector. Furthermore, the policy would not cost taxpayers a dime. In fact, it would eventually reduce the federal budget deficit significantly. Plus, there are a few nice side effects, like reducing our trade deficit, making our economy more efficient, ameliorating global warming, and showing the world that American capitalism has not lost its edge.

What is this miraculous policy? It's called a carbon tax—really, a carbon dioxide tax—but one that starts at zero and ramps up gradually over time.

The timing is critical. With the recovery just starting—we hope—to gather steam, this is a terrible time to hit it with some big new tax. Hence, while the CO2 tax should be enacted now, it should be set at zero for 2011 and 2012. After that, it would ramp up gradually. Adapting some calculations from a recent paper by Prof. William Nordhaus of Yale, the tax might start at something like $8 per ton of CO2 in 2013 (that's roughly eight cents per gallon of gasoline), reach $25 a ton by 2015 (still just 26 cents per gallon), $40 by 2020, and keep on rising. I'd like to see it top out at more than $200 a ton in, say, 2040—which is higher than in Mr. Nordhaus's example.

But the time pattern is more important than the exact dates and numbers. What's critical is that we lock in higher future costs of carbon today. The key thing, as the president said, is that "businesses know there will be a market for what they're selling."

Think about what would happen. Once America's entrepreneurs and corporate executives see lucrative opportunities from carbon-saving devices and technologies, they will start investing right away—and in ways that make the most economic sense. I don't know whether all this innovation will lead to 80% of our electricity being generated by clean energy sources in 2035, which is the president's goal. But I can hardly wait to witness the outpouring of ideas it would unleash. The next Steve Jobs, Bill Gates and Mark Zuckerberg are waiting in the wings to make themselves rich by helping the environment.

Jobs follow investment, and we need jobs now. Even if our economy manages 4% growth for several years in a row, unemployment is destined to remain high for years. We have become accustomed to grading stimulus programs on their "bang for the buck." The 2009 Recovery Act, for example, was expected to cost $90,000-$100,000 for each job created. The "bang for the buck" from a phased-in carbon tax would be infinite at first: lots of jobs at zero cost to the federal budget.

Furthermore, many of the new jobs will be good jobs with good wages, just what America needs right now. It is probably true, as some critics say, that much of the resulting manufacturing activity will move offshore—eventually. But not necessarily right away. And besides, many of the best jobs—in design, sales, marketing and executive positions—will remain in the U.S.

Another salutary effect would be that no one would pay higher taxes for the first two years or so. Using Mr. Nordhaus's tax rates as an illustration, the tax would begin to bring in revenue starting in 2013—a trickle at first but building. Mr. Nordhaus estimates $123 billion in annual tax revenue in 2015 and $282 billion by 2025. If we eventually hit a $200 per ton tax rate, the tax yield would be close to 2% of GDP.

No one likes to pay higher taxes. But every realistic observer knows that closing our humongous federal budget deficit will require a mix of higher taxes and lower spending as shares of GDP. Forget about value-added taxes and other new levies you may have heard about. A CO2 tax trumps them all.

Among the major benefits is that a carbon tax would reduce oil imports. Everyone knows that we import too much oil—even if we ignore the fact that much of what we pay for it goes to countries that are not exactly friendly to us. In recent years, our imports of energy-related petroleum products have accounted for nearly two-thirds of our overall trade deficit in goods and services.

Everyone also knows that CO2 emissions are the major cause of global climate change, that climate change poses a clear and present danger to our planet, and that the U.S. contributes a huge share of global emissions. Up to now, our country has done approximately nothing to curb CO2 emissions. A stiff tax would make a world of difference. Let's remember that even a tax of $200 per ton 30 years from now won't turn us into France. (A carbon tax would have very large effects on the cost of energy generated by burning coal, but essentially none on the costs of nuclear, solar, or wind-generated energy.)

I know this sounds like a pipe dream now. America has elected a Republican House of Representatives that, among its first acts, decided that tax increases don't really add revenue and that tax cuts don't really lose revenue—at least not any revenue they are willing to count. These folks are not about to vote for a CO2 tax, even one starting at zero.

But let's remember Winston Churchill's marvelous aphorism: "You can always count on Americans to do the right thing—after they've tried everything else." First, we'll try everything else. But eventually we'll succumb to the inexorable logic of a phased-in CO2 tax. Just watch—if you're young enough to live that long.

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